Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Application of	§	
SBC Communications Inc. Pursuant to	§	**CC Docket No. 00-4**
Section 271 of the Telecommunications	§	
Act Of 1996 to Provide In-Region	§	
InterLATA Services in Texas	§	

COMMENTS OF THE TEXAS OFFICE OF PUBLIC UTILITY COUNSEL

The Texas Office of Public Utility Counsel (Texas OPC) respectfully provides its Comments on the above-styled application. On January 10, 2000, SBC Communications Inc. and its subsidiaries, Southwestern Bell Telephone Company and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Long Distance (collectively SBC) filed an application for authorization to provide in-region interLATA service in the State of Texas, pursuant to § 271 of the Communications Act of 1934, as amended (the Act), 47 U.S.C. § 271. The Federal Communications Commission (Commission) issued a Public Notice on that application on the same day. In that Notice the Commission set January 31, 2000, as the deadline for comments by interested third parties in support of or in opposition to SBC's application.

I. Introduction

Texas OPC is the Texas state agency designated by that state's laws to represent the residential and small commercial utility consumer interests of that state. It is responsible for representing those interests before Texas and federal regulatory agencies as well as the courts. Texas Utilities Code §§ 13.001-13.063. Texas OPC participated in the Texas Public Utility Commission's (PUC) investigation of SBC's application for provision of interLATA service in Texas. PUC Docket No. 16251. Texas OPC offers these comments on the § 271 request due to

its concern that residential customers benefit from local competition and the expansion of long distance competition to the same degree as business customers.

In return for its support of this § 271 application the PUC and various CLECs have negotiated with SBC a very complex package of commitments, actual realized improvements in performance, and a program of performance measurements and incentives. This process of negotiation began with the PUC order of June 1, 1998, which directed Commission staff to establish a collaborative process to "institute a series of specific commitments and obligations by SBC" which would "allow the Commission to reach a positive recommendation to the FCC on SBC's application."[1] The performance measurement approach utilized in the Texas Collaborative Process has provided a model other jurisdictions will likely follow. As a result of this collaborative process, the PUC has developed a program that measures SBC's performance in over 131 areas through the use of 1874 submeasures. Failures to meet these measures could result in SBC liability to CLECs and the state treasury of as much as $289 million. The PUC relies on this detailed set of measures to ensure that service to competitors, equivalent to that which SBC provides to itself and affiliates, is available now and continues to be available into the future. These performance measures and associated liquidated damages and assessments are crucial to the PUC's determination that SBC has irreversibly opened the Texas local exchange market to competition. In a sense, the PUC's resulting program represents the fullest possible development of the performance measuring approach.

Texas OPC submits that while the use of performance measurements with liquidated damages is a theoretically promising approach to enforcing compliance with the statutory

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[1] PUC Order No. 25, Adopting Staff Recommendations; Directing Staff to Establish Collaborative Process, Docket No. 16251, Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Market. See Texas PUC Proceeding, Docket No. 16251 Record, at Vol. 62, Tab 847.

requirement of non-discriminatory access, it has yet to be proven historically to be an effective form of regulation. Moreover, the approach is not a panacea, and its usefulness is limited when faced with problems involving incentives and information availability.

As a practical matter, SBC's natural incentive will be to subvert the functioning of the program. Moreover, a performance measurement program, even with 131 Categories and 1874 Reported Submeasures, will necessarily be incomplete in the sense that it cannot anticipate and proscribe all the means by which SBC, or any other RBOC, can frustrate the intent of a performance-monitoring program. In addition, changing circumstances in the telecommunications industry will certainly create new opportunities that cannot now be anticipated or measured with any precision. Given SBC's incentives, expected re-negotiations of the terms of the plan as unanticipated contingencies arise will not provide any concrete assurance that the Texas local exchange market will remain irreversibly open to competition. It should not, therefore, be the expectation of the Commission that its job will be complete once it approves SBC's § 271 entry in this case.

Given the limitations of the performance measurement approach in general and the Texas performance remedy plan in particular, Texas OPC recommends that the Commission should base its consideration of this application primarily on evidence of actual, facilities-based competitive entry on a scale that assures that the requisites of local competition will remain in place. Texas OPC makes this recommendation because of its belief that facilities-based competition represents the most sustainable form of entry in the long run. Insofar as the Commission chooses to rely on the performance measurement approach, Texas OPC recommends that any reliance on the Texas performance remedy plan must be conditioned by a explicit provision for the PUC or this Commission to amend the plan through an expedited

proceeding upon motion of an affected party or sua sponte as circumstances dictate. This continuing jurisdiction is a necessary adaptation to the entrant's expected continuing incentives and the inevitable incompleteness of any performance measurement plan.

II. Reliance on Performance Measures To Evaluate The Status Of Local Competition Is Of Limited Practical Value.

A. The Incumbent's Natural Incentive Is To Avoid Compliance With The Performance Measurement Plan.

Well functioning competitive markets discipline competitors to offer combinations of price and quality that are attractive to customers. Performance measurement has a place in commercial contracts wherever quality is complex enough to require formal measurement, and the cost of measurement is justified. Providers in a competitive environment are often eager to fashion performance measurements that accurately capture the dimensions of quality that matter most to customers. Furthermore, providers facing competition will seek to excel in the dimensions of quality that adopted performance measurements seek to capture. Such firms seek to abide by the spirit of the performance measurement program rather than the letter of the program - failure to do so will lead to the loss of business to more responsive competitors. If circumstances change so that the adopted performance measurement program becomes less effective for its intended purpose, re-negotiation of the contract will not generally present insurmountable problems.

While performance measurement with liquidated damages is a promising regulatory tool, it should be borne in mind that it is a regulatory tool - compulsory performance measurement with liquidated damages cannot create, by fiat, the incentives of a competitive market. The full cooperation of SBC, as the incumbent local exchange company, is necessary for the development of competition in SBC's local exchanges. This support cannot be conjured into existence by

requiring a performance measurement program. Rather, the performance measure approach essentially amounts to periodic self-reporting subject to fairly detailed business rules.

Competitive firms engaged in a line of business where performance measurement is indicated have an incentive to structure and abide by a performance measurement program that actually serves customers. An ILEC compelled to enter into a performance measurement program to demonstrate the openness of its local exchange market has no such incentive. As circumstances change in such a way as to require modification of a performance measurement program, an ILEC will have to be forced to accept revisions by a force at least as great as was required to compel initial acquiescence.

B. Evidence Of Successful SBC Performance Measurement Compliance Should Be Secondary To Evidence Of Actual Successful Entry by CLECs.

The PUC negotiated significant concessions from SBC that will undoubtedly improve prospects for the development of competition. The Commission should bear in mind, however, that performance measurements, as a means to ensure that the local exchange market is open to competition, must be regarded as a weaker guarantee than a history of successful entry and growth of local competitors. As the Commission noted in the Ameritech Order[2], "The most probative evidence that all entry strategies are available would be that new entrants are actually offering competitive local telecommunications services to different classes of customers (residential and business) through a variety of arrangements ..." Faced with a situation in which the most probative evidence of broad-based competitive entry was lacking (insufficient broad-based successful entry), the Commission found that performance measurement can play a role as

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[2] Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services In Michigan, Memorandum Opinion and Order, CC Docket No. 97-137, FCC 97-298 at ¶ 391.

a measure of "a BOC's present compliance with its obligation to provide access and interconnection to new entrants in a nondiscriminatory manner."[3]

Beyond this first role for performance measurement, the Commission also noted a second role of allowing new entrants and regulators to "measure performance over time and to detect and correct any degradation of service once a BOC is authorized to enter the in-region, interLATA services market."[4] It is this second role of ensuring continued openness that the PUC relies on in making its recommendation for approval.

No program of performance measurement and financial incentives will create irreversible competition in the local exchange market. As Texas OPC has already noted above, the absence of any incentive by SBC to abide by the spirit of the performance measurement provisions and, more importantly, to renegotiate those provisions as contracts expire or as circumstances change, render the performance measure approach of limited value. Texas OPC also regards it as very unlikely that the present plan adequately anticipates the wide range of opportunities to game the system which will later appear as circumstances in the industry change.

III. Reliance On Performance Measurement Alone Cannot Guarantee That Future Conduct Will Be Reasonable

A. A Once-For-All Contract Imposes Limitations

The PUC's support of the SBC application and SBC's commitments, notably to the Performance Remedy Plan, amount to a contract: an exchange of promises with detailed provision for liquidated damages. As is the case with most contracts, this contract cannot

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[3] *Id.* at ¶ 393.
[4] *Id.*

anticipate all contingencies that may arise over the term of the contract.[5] Future contingencies are especially difficult to anticipate in the present telecommunications industry. This contract, more than most, is unlikely to anticipate all contingencies; the contract is situated in an environment of rapidly changing technology, unsettled market conditions, and strategic behavior. These conditions, which exacerbate the inevitable incompleteness and growing irrelevance of aging once-for-all contracts, show no signs of abating over the life of this contract. For example, negotiations, which ultimately lead to the present understanding between SBC and the PUC, were begun before incumbents' DSL offerings were widely deployed and heavily marketed, and before this Commission had required new forms of collocation[6]. Furthermore, beyond opportunities, which currently exist in the plan, future events can create new opportunities. Any event that could provide a mechanism for or improve the profitability of some form of strategic non-compliance or compliant anti-competitive behavior is a potential unanticipated contingency that will vitiate the effectiveness of a performance measurement plan.

The plan due to its focus on OSS does not address affiliate-related strategic behavior, which would not compromise the performance measures themselves but may have as anti-competitive of an effect as full-blown ILEC discrimination on local competitors whose strategy is to couple local entry with bundling. Texas OPC also suggests that the Commission address ways for it to deal with "compliant anti-competitive behavior." Compliant anti-competitive behavior is strategic behavior that complies with the terms of the performance measurement plan, but nevertheless has an anti-competitive effect. The Commission should recognize the ability of the applicant to engage in near anti-competitive behavior (such as persistently reporting

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[5] "It is generally appreciated that complete contracts of this kind are impossibly complex to write, negotiate, and enforce." Oliver E. Williamson, "Franchise Bidding for Natural Monopolies -- in General and with respect to CATV," Bell Journal of Economics 7, Spring 1976, p. 79.

satisfactory results for the CLECs within the performance measure range, although only marginally so). These types of behaviors can have as invidious of an effect on local competition long-term as more egregious behavior.

B. Resistance To The Introduction Of Competition Will Persist In A Performance Measurement Environment.

The SBC approach does not solve the problem of actions and events not anticipated by the contract; it merely shifts the ground. Under the performance measurement approach, the realm of actions and events which constitute important unanticipated contingencies shifts from the company's violation of a regulatory directive to the adequacy of adopted performance measures to capture and punish such a violation. Moving to a performance measurement environment closes off some forms of resistance but opens others.

It is impossible to point clearly and in detail to important contingencies that have not been anticipated by the performance measurement plan. There is a long history of resistance to the efforts of public policy to open telecommunications markets to competition. This history should inform the Commission's present efforts with performance measurement programs because it illustrates the wide range of unanticipated contingencies that can interfere with the objectives of public policy. If opportunities for resistance were anticipated, they could be eliminated in advance. If unanticipated, they frustrate implementation of public policy.

The first widely known instance of this phenomenon occurred with the Commission's *Hushaphone* Order directing AT&T to file tariffs complying with the 1956 court decision in *Hushaphone*. The compliance tariff filing ironically introduced a means for resisting other competitors, which was not anticipated in the *Hushaphone* Order. This unanticipated mechanism

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[6] FCC Advanced Services Order.

for resistance remained in effect until 1968 when the Commission found that the tariff had "been unreasonable and unreasonably discriminatory since its inception."[7]

A recent illustration of this phenomenon is provided by this Commission's protracted (and continuing) effort to compel ILECs to allow collocation of competitors' equipment in their premises under reasonable terms and conditions. The Commission's recent *Advanced Services* Order[8] illustrates some of the actions and events, which if not anticipated, can frustrate efforts to implement public policy. While this illustration points to contingencies that were not anticipated in drafting Commission orders, such opportunities for resistance are no more likely to be perfectly foreseen in the drafting of a performance measurement program.

In the *Advanced Services* Order, as it relates to previously ordered collocation arrangements, the Commission clarified previous orders as a "step towards elimination of obstacles to competition."[9] Several avenues of resistance were addressed in that order: placement of multifunctional equipment, cross-connects between collocators, and equipment safety requirements imposed on collocators' equipment. In each case the incumbents' interpretation of previous Commission orders had erected an "obstacle to competition." In the latter two cases the opportunities for strategic behavior were probably present in the Commission's order, but not anticipated. In the first case - placement of multifunctional equipment - unanticipated events in changing technology created, or enhanced, the opportunity for strategic behavior: "Given the technological trend towards integrated telecommunications equipment, requiring competitive LECs to purchase single-function equipment would relegate

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[7] Quoted in Gerald W. Brock, The Telecommunications Industry: The Dynamics of Market Structure, Harvard University Press, Cambridge, 1981, p. 241.

[8] In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, First Report and Order and Further Notice of Proposed Rulemaking, adopted March 18, 1999, released March 31, 1999.

competitors to less efficient equipment and create unnecessary roadblocks to competitive entry."[10]

In the present case, the realm of actions through which an incumbent can resist effective introduction of competition is different in a performance measurement environment than in an environment of direct orders to facilitate competitive entry. Several aspects of the agreement hint at SBC's opportunities in the performance measurement environment for strategic non-compliance or compliant anti-competitive behavior:

- To the extent that data collection, underlying the calculation of performance measures, rests on internal SBC practices, these collections will be very difficult to specify without leaving some degree of discretion in SBC. As a result, the reliability of the affected performance measures becomes difficult to monitor. Any ambiguity creates an opportunity for resistance to the development of competition.[11]
- Reliance on a parity standard alone without also imposing benchmarks may allow SBC to gain an advantage through raising rivals' costs by selectively reducing performance levels. Such a strategy may be attractive even when it raises the incumbent's cost as well the rival's.[12] For instance, reducing performance of EASE average response time (a parity measure) during high use times when the measure is important to competitors (during promotions) would not violate parity, but would disproportionately harm the competitor.
- Reliance on benchmarks alone, without also imposing a parity requirement, will allow the incumbent to provide marginally inferior service to entrants, relative to service provided to affiliate retail operations, without violating the benchmark. The latitude for this form of compliant anti-competitive behavior will increase as technology improves the best practice level of performance. In fact, over time as service quality levels improve, static benchmarks may become too outdated to be a reliable indicator of non-discriminatory conduct. As the Commission recognized in

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[9] *Id.* at ¶ 29.

[10] *Id.* at ¶ 31.

[11] A discussion of some of these issues are at AT&T's letter to ALJ regarding retroactive changes to performance data and other Validation Concerns, PUC Project 20000, dated 12 May, 1999. See Texas PUC Project No. 20000 Record at Vol. 1, Tab 21. For a discussion of inconsistent data describing the same performance submitted by Bell Atlantic - New York and AT&T, see Letter/Ruling Accepting Staff Analysis and Closing the Technical Conference Process, 16 August 1999 by Administrative Law Judge Eleanor Stein, New York Department of Public Service Case 97-C-0271.

[12] Salop, S. C. and Scheffman, D. T., "Raising Rivals' Costs," American Economic Review 73, 1983, pp. 267-271.

the Michigan Order[13], "the development of OSS functions is not a static process, and we encourage and expect Ameritech continually to make improvements to its operations support systems, even after it has filed a section 271 application." This technological improvement element implies increasing latitude between best practice performance and an outdated benchmark.

- The plan provides some latitude for random variations before invoking damages and assessments. A willingness to incur some costs in the form of damages and assessments (which is possible) turns the worst instances of any form of compliant anti-competitive behavior into examples of strategic non-compliance.

C. A Reliable, Self Enforcing Performance Measurement Program Must Recognize Changing Conditions

Texas OPC suggests above that it is useful to regard SBC's commitments as an incomplete contract which admits unanticipated contingencies. The present agreement severely restricts the jurisdiction of the PUC after implementation of the agreement. Paragraph 6.4 of the Performance Remedy Plan provides for a review of the plan every six months. These six-month reviews are to cover possible additions, deletions or modifications of measures as well as reclassification of measures as to High, Medium, Low, Diagnostic, Tier-1 or Tier-2 status. The set of criteria for reclassification is severely restricted: "The criterion for reclassification of a measure shall be whether the actual volume of data points was lesser or greater than anticipated."[14] Reclassification, as well as any changes to existing measures can only occur by mutual agreement. "Any changes to existing performance measures and this remedy plan shall be by mutual agreement of the parties and, if necessary, with respect to new measures and their appropriate classification, by arbitration."[15] Thus, any changes to the plan require SBC's consent, although matters related to new measures and their classification can be arbitrated by the PUC. T2A ¶ 6.5 contemplates a two-year review, but only to reduce the number of

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[13] Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services In Michigan, Memorandum Opinion and Order, CC Docket No. 97-137, FCC 97-298, at ¶ 153.

[14] Performance Remedy Plan, 6.4.

performance measures. A need exists for continuing jurisdiction to administer the contract as unanticipated contingencies arise and the industry changes. While the plan is silent as to the nature of any arbitration, which the PUC might undertake, Texas OPC suggests that the Commission explicitly allow the PUC considerable more latitude in the first six month review, at the very least. This first review after entry approval represents the principal opportunity for the PUC to verify that existing performance measures work as anticipated or to change the performance measures, as circumstances indicate, through arbitration as well as by mutual agreement. See T2A ¶ 6.4.

D. Adaptations To Changing Circumstances Can Be Incorporated Into A Performance Measurement Program.

SBC has elsewhere previously agreed to a more effective form of continuing jurisdiction than is found in the Texas plan. The Ohio merger stipulation, for example, shares the objectives sought by the PUC: irreversible opening of the local exchange market to competition. That stipulation contains the following provision:

> For a minimum of one year following the Merger Closing Date, and thereafter on an as-needed basis as determined by Staff, participants in the collaborative process will collaborate to implement any additions, deletions, or changes to the performance measurements, standards/benchmarks, and remedies that are implemented by SBC/Ameritech in Ohio. Any participant may propose such addition, deletion, or change based upon experience with such implemented performance measurements, standards/benchmarks, remedies, or any other factor. If a dispute over any such addition, deletion, or change cannot be resolved through the collaborative process, any participant may ask the Commission to resolve such dispute. The participant proposing the addition, deletion, or change retains the burden of proving that such addition, deletion, or change should be adopted in Ohio.[16]

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[15] *Id.*

[16] Stipulation and Recommendation, Public Utilities Commission of Ohio Case No. 98-1082-TP-AMT, February, 23, 1999, ¶IV.D.11.

A similar commitment was made in Illinois in response to a Commission concern regarding liquidated damages provisions considered in relation to their merger application.[17]

Note that the above paragraph provides for a collaborative process that will continue so long as the state commission staff determines that it is needed. A wide range of matters is potentially open for consideration in the collaborative process. The collaborative can consider any change, addition or deletion to measurements, benchmarks, or remedies. Importantly, failures of agreement within the collaborative will be resolved, without restriction, by the state commission.

IV. Conclusion and Recommendation

Reliance on a performance measurement program is fraught with potential problems. The performance remedy plan is incomplete in the sense that it cannot anticipate and provide for all contingencies. Beyond problems with the plan, changing circumstances in the telecommunications industry will certainly create new opportunities that cannot now be anticipated with any precision through the set of given performance measures. Given SBC's incentives, faith in the re-negotiation of the terms of the plan as unanticipated contingencies arise will not provide any guarantee assurance that the Texas local exchange market will remain open to competition.

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[17] Illinois Commerce Commission Case 98-0555, Hearing Examiner's Proposed Order on Reopening, August 10, 1999, p. 107 & 108.

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